

STATE OF IOWA
DEPARTMENT OF COMMERCE
UTILITIES BOARD

IN RE: U S WEST COMMUNICATIONS, INC., AND QWEST INC.	DOCKET NO. SPU-99-27
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**ORDER APPROVING SETTLEMENT
AND TERMINATING DOCKET**

(Issued March 17, 2000)

On September 20, 1999, Qwest Communications Corp., LCI International Telecom Corp., USLD Communications Inc., Phoenix Network Inc., and Qwest Communications International Inc. (collectively "Qwest"), and U S WEST, Inc., filed a joint application for an order approving the proposed merger of Qwest Inc. and U S WEST, Inc. (collectively, the "Applicants"), pursuant to Iowa Code §§ 476.76 and 476.77 (1999). U S WEST, Inc., is the parent company of U S WEST Communications, Inc. (U S West), a provider of regulated telecommunications services in Iowa. The filing has been identified as Docket No. SPU-99-27.

On October 7, 1999, the Consumer Advocate Division of the Department of Justice (Consumer Advocate) filed a motion for extension of time in this docket for an additional 90 days, pursuant to Iowa Code § 476.77(2). On October 11, 1999, McLeodUSA Telecommunications Services, Inc. (McLeod), filed a joinder in the motion for extension of time.

On October 13, 1999, AT&T Communications of the Midwest, Inc. (AT&T), filed a petition to intervene, which was granted on November 8, 1999.

On October 20, 1999, the Applicants filed a response to the motion for extension of time, proposing an initial extension of 30 days, rather than the 90 days requested by Consumer Advocate.

On October 26, 1999, the Board issued an order granting Consumer Advocate's motion to extend the time for review of the Application by 90 days and setting a procedural schedule.

On November 5, 1999, the Board issued an order requiring the Applicants in this docket to file certain additional information by November 19, 1999. On November 9, 1999, Consumer Advocate filed a request for an extension of time to file its prepared direct and rebuttal testimony. Under the original procedural schedule in this matter, Consumer Advocate's prepared direct testimony in this docket was due on November 22, 1999. Consumer Advocate requested an extension of that deadline to December 3, 1999, to permit Consumer Advocate an opportunity to review the additional information to be filed by the Applicants. Also on November 9, 1999, McLeodUSA filed a joinder in Consumer Advocate's request.

On November 18, 1999, the Board granted the request for extension of time and revised the procedural schedule accordingly.

On November 15, 1999, the Association of U S WEST Retirees and the NWB/U S WEST Retiree Association (collectively, the Retiree Associations) filed a

petition to intervene in this matter, which was granted by Board order issued December 3, 1999.

On November 23, 1999, AT&T filed a motion to compel and for extension of time, seeking an order directing the Applicants to respond to certain of AT&T's outstanding data requests. On December 1, 1999, the Applicants filed a resistance to the AT&T motion, and on December 7, 1999, the Board issued an order denying the AT&T motion but directing the parties to enter into a protective agreement and complete discovery in a timely manner.

On January 6, 2000, AT&T filed a second motion to compel, stating the parties had entered into a protective agreement but the Applicants had yet to provide complete responses to many outstanding AT&T data requests. Applicants resisted the AT&T motion, but on January 19, 2000, the Board issued an order granting AT&T's motion to compel and giving AT&T an additional opportunity to file supplemental direct testimony in advance of the hearing.

On January 28, 2000, the Applicants and Consumer Advocate filed a proposed settlement agreement and a joint motion for approval of the agreement. The proposed settlement was intended to resolve all issues between the Applicants and Consumer Advocate. The other parties to this docket did not participate in the negotiation of the proposed settlement and were not parties to it. They continued to urge the Board to disapprove the proposed merger as being inconsistent with ratepayer interests and the public interest (unless the Applicants make certain

commitments intended to alleviate the public interest concerns identified by each of the intervenors).

Hearings were held in this docket on February 1, 2, 3, and 14, 2000, at which time the prefiled direct, supplemental, and rebuttal testimony was spread on the record and witnesses were made available for cross-examination. Briefs were filed by all parties on February 21 and 25, 2000.

STATUTORY FACTORS

Iowa Code § 476.77(3) lists the following factors that the Board may consider in its review of a proposal for reorganization:

- a. Whether the board will have reasonable access to books, records, documents, and other information relating to the public utility or any of its affiliates.
- b. Whether the public utility's ability to attract capital on reasonable terms, including the maintenance of a reasonable capital structure, is impaired.
- c. Whether the ability of the public utility to provide safe, reasonable, and adequate service is impaired.
- d. Whether ratepayers are detrimentally affected.
- e. Whether the public interest is detrimentally affected.

These standards indicate some of the most important questions for the Board to consider are the impacts of the reorganization on the utility's ability to attract capital, the utility's ratepayers, and the public interest generally.

A. WHETHER THE BOARD WILL HAVE REASONABLE ACCESS TO BOOKS, RECORDS, DOCUMENTS, AND OTHER INFORMATION RELATING TO THE PUBLIC UTILITY OR ANY OF ITS AFFILIATES

Applicants state that the merged company will provide the same access to books and records that U S West, Inc., provides today and the merger will not alter the reporting obligations of U S West, Inc., to the Board. (Tr. 541-42). They further state that U S West will also continue to provide the same access to the books and records that U S West provides today. Applicants also state that any affiliate transaction subsequent to the merger will be reported to the Board as required. (Tr. 541-42). Finally, in Paragraphs 15 and 16 of the settlement, Applicants agree (a) to make all records equally available to the Board and Consumer Advocate as required by 199 IAC 31.2; (b) to reimburse any expenses incurred by Consumer Advocate or the Board or their contractors in accessing such records outside the state; and (c) to maintain accounting records for Iowa regulated operations as required by 199 IAC 16.5 or such other rules as may apply.

These assurances appear to be sufficient to establish that, following the merger, the Board (and Consumer Advocate) will continue to have reasonable access to the books, records, documents, and other information relating to the public utility or any of its affiliates. No party has seriously challenged the Applicants' showing with respect to this factor. Moreover, if access to the books and records of the merged entity or any of its affiliates becomes an issue in the future, the Board has authority to address those issues at that time.

B. WHETHER THE PUBLIC UTILITY'S ABILITY TO ATTRACT CAPITAL ON REASONABLE TERMS, INCLUDING THE MAINTENANCE OF A REASONABLE CAPITAL STRUCTURE, IS IMPAIRED

Applicants assert that the merger will not affect the regulated company's ability to attract capital at a reasonable cost (Tr. 45, 539) or its capital structure. (Tr. 541). Applicants provide further assurance in this respect through Paragraphs 10 and 12 of Article VII of the Settlement, which appear to be intended to protect Iowa customers from at least some of the financial and business risks associated with the merger.

Applicants argue that U S West's cost of equity is dependent upon the risks faced by U S West, and these will not change as a result of the merger. These risks include competitive industry dynamics and regulatory risks. (Tr. 540-41). Applicants recognize that U S West's credit rating may decline as a result of the merger. (Tr. 540). However, in Paragraphs 10 and 12 of the settlement, Applicants provide assurances that regulated rates will not increase "by reason of the effects of credit rating declines or other adverse consequences directly caused by the merger." (Tr. 1050). This commitment to adjust debt costs would apply in any proceedings before the Board in which U S West's capital costs are at issue. (Tr. 1055).

Overall, Paragraphs 10 through 12 of Article VII of the Settlement Agreement appear to be intended to provide the Board with some assurances regarding the merged company's willingness to maintain U S West's capital structure and financial integrity, but those assurances include a number of limitations that limit their value:

(1) the settlement lacks a guarantee of a minimum equity ratio, which would directly relate to protecting and maintaining U S West's capital structure; (2) Paragraph 10 of the settlement, prohibiting U S West affiliates and parent from incurring debt or other obligations with recourse against the assets of U S West, is of a very limited duration, as it expires on January 1, 2001; and (3) Paragraph 10 also exempts U S West subsidiaries from these non-recourse debt provisions. These limitations detract from the effectiveness of the Applicants' assurances, but the settlement nonetheless provides some protection from adverse financial effects during the earliest stages of the merger, when protection may be most important. Moreover, the Applicants' general commitment in Paragraph 12, assuring that capital costs included in regulated rates will not be adversely affected by the merger, has no termination date and should provide a continuing level of rate protection to Iowa customers of the regulated entity.

The Board finds that, based upon the facts and circumstances of this case, the provisions of the Settlement Agreement are minimally sufficient to permit the Board to find that the proposed merger is unlikely to have a significant adverse effect on U S West's ability to attract capital on reasonable terms, including U S West's ability to maintain a reasonable capital structure.

However, to ensure that Board can monitor U S West's capital structure in the future, Applicants will be required to file, by March 31 of each year for the next 5 years (beginning in 2001), an update of the information shown in U S West Exhibit 27. Applicants shall append to that report a brief explanation of any financial

arrangements made for the benefit of affiliates or parents of U S West that would permit a creditor, upon default, to have recourse to any U S West assets necessary to the provision of regulated service in Iowa.

C. WHETHER THE ABILITY OF THE PUBLIC UTILITY TO PROVIDE SAFE, REASONABLE, AND ADEQUATE SERVICE IS IMPAIRED

On November 5, 1999, January 14, 2000, and February 4, 2000, the Board ordered the Applicants to provide certain additional information in support of their application. U S West filed its first round of additional information on November 19, 1999, including information regarding U S West's compliance with the service quality measures established by the Board in 199 IAC 22.6, along with a request for confidential treatment of the performance numbers contained in the filing. Pursuant to that request, the Board has ordered that the specific performance measures be kept confidential, pursuant to 199 IAC 1.9, and this order will therefore discuss U S West's performance only in general terms. Based on the information filed by U S West, it is clear that U S West's service quality in Iowa has been deficient and in violation of Board requirements.

For example, 199 IAC 22.6(3)"a" provides a standard for clearing service interruptions. The rule requires that 85 percent of all out-of-service trouble reports must be cleared within 24 hours; 95 percent within 48 hours; and 100 percent within 72 hours, all measured by three-month rolling average. U S West's filing shows that U S West failed to meet two or more of these standards in each month throughout the period of March 1998 through September 1999.

Another example is 199 IAC 22.6(3)"h," which provides that the rate of trouble reports per month cannot exceed 4 reports per 100 access lines in each wire center. Based upon the information filed by U S West, it appears that during the time period of March 1998 through September 1999, U S West violated this standard at least 4 times in each of 29 different wire centers in Iowa. In one wire center, U S West received more than 4 trouble reports per 100 access lines in every month of the 19-month reporting period. The Applicants have stated they are in the process of preparing a plan to address the service problems in these exchanges. (Tr. 246).

U S West's November 19, 1999, filing also shows an excessive level of held orders. The Board's rules do not specify a maximum number of held orders for telephone utilities, but they require that primary local exchange service should normally be provided within 15 business days of the customer's request. 199 IAC 22.6(2)"c." When orders cannot be filled in this time frame, they become held orders. The Board has previously expressed concern with the level of U S West's held orders. See Docket No. FCU-95-1. The additional information filed by U S West on November 19, 1999, indicates that U S West's held orders were at an unreasonable level during much of the time period of March, 1998, through September, 1999.

At the hearing in this docket, U S West recognized that its held order numbers have been unacceptable and stated that it is making additional investments and adding new employees as a part of its plan to reduce the level of held orders for primary service. (Tr. 192).

The proposed settlement includes a variety of provisions intended to address these service problems, all in Article VII. Paragraph 2 of the settlement provides that the Company will give credits to affected customers whenever trouble reports in a wire center exceed the Board's standards in three months out of any 12-month period. Paragraph 3 provides for customer credits for residential and business customers whose trouble reports are not cleared within 48 hours. Paragraph 4 specifies new customer credits and alternative service options for customers who are subject to held orders for primary line connections. At the hearing, Applicants modified this proposal by agreeing to make refunds to any customers who may be entitled to credits but who change local service providers, such that they are no longer eligible for a credit on a U S West bill. (Tr. 1215-16).

Paragraph 5 is also addressed to held order situations and requires the Company give written notice to customers, at the earliest possible time, when it becomes apparent service will not be installed in a timely manner. The notice will include information regarding the alternative service options available to the customer.

Paragraph 6 establishes target levels for held order for primary service, based upon a three-month rolling average of held orders in excess of 30 days. At hearing, U S West agreed that the targets should be considered a standard that U S West must meet and that the Board can enforce and that these standards should be calculated using only certain types of change orders, that is, change orders that require provisioning a line or that involve wholesale service. (Tr. 1216).

Paragraph 7 provides that the Applicants will work with Consumer Advocate to develop enhanced reporting formats to permit monitoring of U S West's compliance with the quality standards established in the Board's rules.

Finally, Paragraph 8 provides that nothing in the settlement agreement is intended to preclude Consumer Advocate or the Board from exercising any authority they have for the purpose of securing compliance with service quality standards or other requirements of law or regulation.

In addition to the commitments made in the settlement, the Applicants have agreed to take other steps intended to address the identified service problems. As stated above, Applicants testified they are in the process of preparing a plan to address the problems with excess trouble reports. They further testified that they would be willing to share the details of those plans with the Board as they are developed (Tr. 246), and the Board will order that Applicants do so. The plans should be filed in this docket as soon as they are finalized, but in no event later than 30 days after the date of this order.

Applicants made the same representations with respect to their held order levels. Again, the Board will order Applicants to file their plans for reducing held orders in this docket as soon as they are finalized, but in no event later than 30 days from the date of this order.

The Board finds that the proposed merger, as originally filed, raised serious questions regarding the possible impact of the merger on U S West's retail service quality in Iowa, service quality that was already deficient and in violation of various

Board standards. The commitments the Applicants made at the hearing in this matter and in the settlement agreement represent a start toward alleviating the existing service problems and preventing any adverse service quality impacts that might otherwise result from the proposed merger. The Board will accept the commitments the Applicants have made, both at hearing and in the settlement, and find that, with those commitments, the merger will not adversely affect U S West's ability to provide safe, reasonable, and adequate service.

However, the Applicants must understand that the performance improvement measures or standards in the settlement agreement represent a floor, not a ceiling. Merely complying with the provisions of the settlement agreement will not automatically equate to furnishing reasonably adequate service and facilities, as required by Iowa Code § 476.8. For example, Paragraph 6 of the settlement establishes target levels for held orders; U S West must understand that, while consistently meeting those targets will represent progress over U S West's past performance, the Board can and will hold U S West to more stringent standards if circumstances warrant. Additionally, if the commitment in the settlement to invest an average of \$90 per access line in Iowa each year for the next two years is insufficient to meet the applicable service quality standards, U S West will be required to make additional investments as necessary.

The effectiveness of this settlement is dependent upon the enforcement of the standards agreed to by Applicants. Compliance with those standards, both those in the settlement and the standards in the Board's rules, must be closely monitored.

Reporting mechanisms have been inadequate in the past. U S West's noncompliance with service quality standards in the past was brought to light through this proceeding and will not be allowed to continue. Therefore, proposals for enhanced reporting mechanisms agreed to by Consumer Advocate and U S West as a part of the settlement will be required to be filed with the Board within 60 days of the date of this order. Until those standards are filed with and approved by the Board, U S West will be required to file information on its performance in each of the deficient areas on a monthly basis, beginning 30 days after the date of this order.

Finally, in order to ensure that the Board will have all of the information necessary to permit monitoring of U S West's retail service quality, the Board will direct that its staff should be permitted to participate in the meetings between Applicants and Consumer Advocate for development of enhanced reporting formats, pursuant to Paragraph 7 of the settlement.

D. AFFECT ON RATEPAYERS

Applicants assert that the merger will have beneficial effects on Iowa ratepayers because it is expected to produce a more customer-focused and efficient company. (Tr. 168). Applicants also assert that, at this time, the merger will not require any changes in the rates, terms, or conditions for the provision of any telecommunications service in Iowa and that the merged company will abide by the terms and conditions of the retail price plan currently applicable to U S West. (Tr. 169).

The main issue on this point revolves around the costs of the merger. U S West assures the Board that “U S West’s portion of the expenses of the merger will be charged to non-operating accounts that are ordinarily excluded from cost-of-service rate making.” (Tr. 535). Paragraph 11 of the settlement provides that the Applicants agree to insulate the Iowa customers of U S West from any adverse impact on the rates, services, or service quality of U S West that may result directly from the merger. This general commitment is bolstered by the more specific commitment of Paragraph 17, which lists a variety of merger-related costs that will not be charged to U S West or any other regulated Iowa utility without the advance approval of the Board.

The Board finds that, with these commitments, Iowa ratepayers will not be detrimentally affected by the proposed merger.

E. AFFECT ON THE PUBLIC INTEREST

The final statutory consideration listed in Iowa Code § 476.77(3) is whether the public interest is detrimentally affected by the proposed merger. The parties have incorporated various issues under the “public interest” factor, primarily the possible impacts on wholesale customers (interconnection issues and interexchange access charge issues) and pension fund issues.

McLeod and AT&T argue that the proposed merger will increase the U S West’s opportunities and incentives to violate federal and state statutes and will therefore slow the development of competition. These parties conclude that the alleged benefits of the merger are outweighed by the likely detriments to competition and urge the Board

to reject the proposed settlement and disapprove the merger application unless U S West and Qwest agree to make certain commitments, including adoption of wholesale service quality measures with predetermined penalties for failure to meet the service standards.

The Retiree Associations argue the Applicants have not provided enough information to determine the potential impact of the merger on U S West's retirees and their pension plans, since the Applicants have only said that they have no plans to change their pension plans "at this time," with no commitment beyond the merger date. The Retiree Associations urge the Board not to approve the proposed merger unless the Applicants agree to present all future pension plan changes to the Board for review before the changes are implemented.

U S West and Qwest argue that reorganization dockets have become a vehicle for pursuing issues before the Board that are unrelated to the actual proposed merger, citing the McLeod, AT&T, and Retiree Association issues as examples. The Applicants encourage the Board to apply the statutory standard of Iowa Code § 476.77(2), which provides that a merger shall be deemed to be approved unless the Board disapproves it, based upon a consideration of the five factors set forth in § 476.77(3). Applicants interpret this to mean that the Board may disapprove a merger only if it will have material adverse impacts on public or ratepayer interests. (App. Init. Br. at p. 20).

In response to the Retiree Associations, Applicants argue that pension plan issues do not belong in this docket, but are instead governed by ERISA and other federal laws.

In response to AT&T and McLeod, Applicants argue that no connection has been shown between the proposed merger and the alleged wholesale service quality questions; that the issues regarding Qwest's divestiture of its in-region interLATA business are speculative and subject to FCC review; that the merged entity will clearly have an increased incentive to comply with § 271 of the Telecommunications Act of 1996; that there is no evidence the Board's regulatory oversight will be hindered by the merger; and that the Board lacks authority to impose conditions on the merger as a part of its approval.

The Board finds that AT&T and McLeod have not shown that the merged entity will really be any worse than U S West has been with respect to these issues. In other words, McLeod and AT&T have not shown that their concerns are merger-related. The Applicants have provided some reason to believe there may be an improvement in U S West's compliance with the requirements of the Telecommunications Act of 1996 after the merger. Primarily, they claim that the merged entity will have an increased incentive to obtain § 271 approval and that wholesale service quality will indirectly benefit from their commitments to make certain capital investments on the retail side. While these alleged benefits are not concrete, enforceable commitments, they appear to be minimally adequate to pass statutory muster. Given this *prima facie* case of competitive benefits from the

merger, AT&T and McLeod have failed to show how the merger itself will actually make things worse.

The Board finds that the Retiree Associations have also failed to connect their issue to the merger in a direct, substantive manner. At present, U S West's administration of the pension plans is subject to the restrictions and obligations imposed by Federal law. The same restrictions and obligations will apply to the merged entity. The Retiree Associations ask the Board to impose new conditions, and give them new protections, as a condition of merger approval. While this might be appropriate if there were some reasonably direct connection between the merger and the pension plans, that connection has not been shown on this record. Instead, the Retiree Associations have expressed only a general concern that the new company may have an increased incentive to take fuller advantage of the rights that U S West already has under federal pension law. This generalized concern does not rise to the level of requiring that the Board reject this merger in the absence of pension fund protecting conditions.

CONCLUSION

The Board concludes that, based upon a consideration of the entire record in this matter and the factors set forth in Iowa Code § 476.77 and 199 IAC 32, the Board will not disapprove the proposed merger of Qwest and U S WEST, Inc., as described in the Joint Application. However, the Applicants are cautioned that this decision is strictly based upon the record in this docket; if any material changes to

the proposed reorganization are agreed to by the parties or are ordered by any other jurisdiction reviewing the proposed merger, those changes must be filed with the Board at the earliest opportunity, accompanied by written testimony describing the changes and the anticipated effect (or lack of effect) on each of the five factors set forth in Iowa Code § 476.77(3).

In order to allow the Board to determine whether any changes agreed to by the Applicants or ordered by another authority are material, the Applicants will be directed to file with the Board copies of any settlements they enter into in other merger review proceedings and copies of any orders Applicants may receive in other merger review proceedings, to the extent the orders approve the merger subject to any conditions or changes. All such filings shall be made within 3 business days of the date the settlement agreement is filed or the date the order is issued in the original proceeding.

ORDERING CLAUSES

IT IS THEREFORE ORDERED:

1. The motion to approve the proposed Settlement Agreement filed by Qwest Communications International Inc., U S WEST, Inc., their subsidiaries, and Consumer Advocate on January 28, 2000, is granted and the settlement is approved, as modified by the agreement of the parties at the hearing in this matter and consistent with the Board's understanding as expressed in the body of this order.

2. Consistent with the terms of the settlement agreement, as modified by the agreement of the parties at the hearing, and to permit the Board to monitor U S West's compliance with the terms of the settlement and other assurances made, U S West is hereby ordered to make the following filings:

a. As soon as the plans are finalized, and in no event later than 30 days from the date of this order, U S West shall file the details of its plans to address the service problems in those exchanges where U S West has experienced repeated violations of the trouble report rule, 199 IAC 22.6(3)"h."

b. As soon as the plans are finalized, and in no event later than 30 days from the date of this order, U S West shall file the details of its plans to address the excessive level of held orders it has experienced.

c. U S West shall file monthly service quality reports based upon the service quality standards in 199 IAC 22.6. Such reports shall be filed 15 days after the end of each month until such time as the Board orders otherwise.

d. Beginning March 31, 2001, and each year thereafter through March 31, 2005, U S West shall file an updated version of U S West Exhibit No. 27, providing information regarding U S West's capital structure. Each such report shall be accompanied by a narrative summary of the type and magnitude of any financial arrangements made for the benefit of any affiliate or parent of U S West that would permit a creditor, upon default, to have

recourse to U S West assets that are necessary to the provision of regulated service in Iowa.

e. At least 60 days prior to closing the merger between Qwest and U S WEST, Inc., U S West shall file proposed tariff pages for Board review and approval that will incorporate the commitments of Paragraphs 2, 5, and 6 of the settlement into U S West's local service tariff.

3. Docket No. SPU-99-27 is terminated. The joint application for reorganization filed by Qwest Communications International Inc., U S WEST, Inc., and their subsidiaries on September 20, 1999, is not disapproved.

4. Applicants shall promptly file with the Board any material changes to the proposed reorganization. The filing shall include an analysis of the impact of any changes.

5. Applicants shall file with the Board 11 copies of any settlements they enter into in other merger review proceedings and 11 copies of any decisions or orders Applicants may receive in other merger review proceedings, to the extent the decisions or orders allow the merger to proceed subject to any conditions or changes. All such filings shall be made within 3 business days of the date the settlement agreement is filed in the original proceeding or the date the order is issued in the original proceeding.

6. Motions and objections not previously granted or sustained are denied or overruled. Any argument not specifically addressed in this order is rejected either as not supported by the evidence or as not being of sufficient persuasiveness to warrant comment.

UTILITIES BOARD

/s/ Allan T. Thoms

/s/ Susan J. Frye

ATTEST:

/s/ Raymond K. Vawter, Jr.
Executive Secretary

/s/ Diane Munns

Dated at Des Moines, Iowa, this 17th day of March, 2000.